Capital Link Shipping
Weekly Markets Report

Monday, July 20, 2015 (Week 29)

Dinner chatter and getting fatter, with the tanker boys

Contributed by

Barry Parker

Barry Parker is a financial writer and analyst. His articles appear in a number of prominent maritime periodicals including Lloyds List, Fairplay, Seatrade, and Maritime Executive and Capital Link Shipping.

Tanker hires continue to soar- with the marquee number- the time charter equivalent on the Baltic Exchange's "TD3" (VLCC, AG to Japan) reaching nearly $94,000/day. This huge bull run is a nice benefit of OPEC's geopolitical gambit of pumping more oil. Oil prices have plunged, again, in the past few weeks, as barrels from what the International Energy Agency described as "…massively oversupplied…" found their way past the manifolds and into the bellies of big oil tankers. Out for dinner last week with some tanker broker friends, one opined: "There's congestion everywhere, it's not just in China and India. Ships are waiting to discharge oil." At this dinner- no mention of "contango."

Tanker stocks are up, but have not rallied commensurately with hires; investors doubt the staying power of the present rally. Indeed, S & P brokers note that "re-sales" or recently built vessels already "on the water" are priced at premiums to newbuilds for delivery two years out. By then, the reasoning goes, there will be many newbuilds, less demand, and the market will have softened…..so it goes.

At some point, the psychology will shift; buyers of tanker stocks will begin to believe in a more sustained run-one that will boost share prices up to levels that reflect a medium term optimism. Here's why: One of my broker buddies explained: "Charterers are thinking about two year charters- but the owners are saying, 'nope- if you want two years, you'll need to take the ship for a third year' ". This comes as the FT is again covering the tanker industry- with a pipeline of quotes from DHT and EURN. If such period deals start getting reported- investors (reading the FT and other mainstream outlets) will see the charters, and articles, and then position themselves for multiple years of rich cash flows, albeit at discounts to the $94,000/day nearby equivalents.

Earlier in the year, I was a big cheer-leader for floating storage on VLCC's- based on that fleeting price relationship that one well known Buy side analysts famously called "the contango thing" at Capital Link's shipping conference in March. In the short term, floating storage, though not of the "contango" variety, may keep the market firm well past the end of 2015. The drop in oil prices has pulled down the entire price curve, not simply the nearby positions- suggesting that traders and analysts are looking for many months of over-supply. So, it's the congestion that will effectively mimic floating storage. We are seeing reports of real contango concerning fuel oil in Singapore; at least one wag has postulated that Jones Act oil could be heading for a contango.

Tanker brokers, in their market reports (rather than dinner-time chatter) suggest that May and June were some of the busiest months ever; one indicator, the number of VLCCs fixed out the Arabian Gulf, registered nearly 140 cargoes for month of June, significantly higher than the count for March (still an above normal month)- at 111.

Tankers are providing temporary storage inventory. According to the IEA (an agency of the OECD which monitors the oil markets), world oil production rose by 550,000 barrels/day during June- to an astounding level, something like a rate of 96.3 million barrels/day, in June. Compared to June of last year, this is up at the rate of 3 million barrels/day. Expressed another way, that's the equivalent of something like 10 VLCCs each week loading "extra oil" and then parking someplace waiting to discharge it.

Analysts look for non-OPEC growth (read "mainly shale oil growth, in The States") to slow down in 2016, as the low prices make production uneconomical. But supply chains are overwhelmed now, and may be for some time, in spite of what happens at Eagle Ford.

Another big issue is the historical deal between Iran and a six nation consortium- "P5+1", that was reached last week. For investors in shipping, the questions boil down to "how soon?" and "how much additional oil would move"?

The lifting of sanctions will be timed based on an "Implementation Day"- a date when Iran's compliance with certain restrictions on nuclear activities is confirmed. According to lawyers Watson Farley Williams, "…No specific date has been fixed for Implementation Day, which could take several months." An initial concern is that Iranian tankers currently storing oil, estimated variously at 20 – 30 ships, could re-enter the markets. Ship-spotters have reported movements of vessels; the mainstream FT (in touch with brokers including Gibsons) has reported one NITC VLCC- "Starla"; bound for Singapore, where it will be better positioned once sales are allowed. The FT also mentioned another Iranian-controlled vessel- "Happiness", now bound for S Korea- where it will be pre-positioned for a quick discharge once oil sanctions are lifted.

Over the next year, following the OK for oil sales, more Iranian crude oil could move, which, by itself, would boost tanker demand beyond the aforementioned oversupply factors. Analysts quoted in financial and trade media see an eventual ramp-up of 1 million barrels/day in Iranian oil production, beyond present levels- including about 1.1 million barrels/day of exports exempted from the sanctions). The Iranian's suggest that they could instantly produce an extra 500,000 barrels/day- presumably destined for export markets, at the time of implementation, and then another 500,000 barrels/day, within another six months- a timeframe roughly in early/ mid 2016. However, these figures have been questioned. Energy experts Wood Mackenzie commented: "….we do not expect Iranian crude to flood the market in the near-term. Moreover, although Iran has around 20 million barrels of oil in storage, some of it is needed for operational reasons domestically and is therefore, not destined for export."

Iran's commercial ties may have frayed during the period of sanctions (imposed on oil exports in 2012); for example, the WSJ notes that Essar, in India (a large customer for Iran), had signed a major supply deal with Rosneft. It was suggested that National Iran Oil Co (NIOC) would need to offer competitive sales terms in order to win back its market share. A more modest view is presented by Wood Mackenzie, who say: "We believe it could take Iran until the end of 2017 to increase production by as much as 600,000 b/d," citing degradation to reservoirs and infrastructure during the sanctions.

Let the good times roll- broker dinners, media mentions, and fattening hires for tankers; bring it all on.